



## **US: NOW THIS IS WHAT A POST-RECESSION BOUNCE LOOKS LIKE!**

- **U.S. GDP grew by a better than expected 5.7% Q/Q ann., representing the fastest pace of quarterly growth since Q3-2003.**
- **A slowdown in the pace of inventory liquidation was the main contributor to growth during the quarter, adding a big 3.6 ppt to the headline print.**
- **Overall, the report was very strong though is not likely to be sustained in the coming quarters due to one-off factors.**

The U.S. economy has continued in its process of recovery, growing by a big 5.7% Q/Q ann. in Q4. This was the second consecutive quarter of GDP growth, and the Q4 report is the first of 2009 to resemble anything like a post-recession bounce. The print came in stronger than market consensus, as well as our own expectations, which were for a print of 4.7% and 5.0%, respectively. On an annual basis, U.S. GDP growth is now up 0.1% Y/Y, which is a vast improvement from the -2.6% Y/Y pace seen in the final Q3 report. The pace of growth during Q4 is the fastest since Q3-2003.

The key factor pushing GDP higher during the quarter can be attributed to the slowing pace of inventory liquidation after deep cuts early in the year. In Q4, the change in private inventories contributed a large 3.6 ppt to the headline print. Not surprisingly, residential investment was also quite positive during the quarter as favourable mortgage rates and good affordability spurred construction and renovations. In Q4, residential investment grew by 5.7% Q/Q ann., contributing 0.14 ppt to the headline number. Private domestic investment was strong, though much of the move higher during the quarter can be traced back to the inventory story. Nonetheless, other areas such as equipment and software contributed favourably as well to quarterly growth, with spending up 13.3% Q/Q ann. Net trade increased during the quarter, and actually added 0.5 ppt to headline GDP, as the 18.1% Q/Q ann. gain in exports was larger than the 10.5% Q/Q ann. growth in imports.

The details of the report were quite strong. Durable goods consumption declined by 0.9% Q/Q ann., though nondurable goods consumption (a smoother indicator for the trend in final demand) grew by 4.3% Q/Q ann., leaving personal consumption expenditures contributing 1.44 ppt during the quarter. Final domestic sales grew for the second consecutive quarter, though the 1.7% Q/Q ann. pace was slower than the 2.3% Q/Q ann. advance in Q3 which provides the true-state of affairs into demand once inventories are stripped out of the equation. On the flip side, there was softness seen in the government spending category, as it subtract 0.02 ppt from overall growth during the quarter after adding positively over the past two quarters.

All things considered, this was a very strong report and is the first GDP report in 2009 to really elicit any semblance of a 'wow' factor. Having said that though, it is quite obvious to us that the rebound during the quarter was not a function of some new-found economic dynamism, but rather it was the slowing pace of inventory liquidation that really dealt the winning hand. The fact that sixty percent of growth can be attributed to this correction suggests the pace of GDP growth going forward will fail to keep pace, though that is not to say growth will stall altogether. Private capital formation was greatly assisted by the swing in inventories. On the trade side of the equation, it is quite clear that a weaker USD during the quarter was a boon to the export market, as net trade is now positively contributing to growth. In terms of the Fed, despite the strong print this quarter, the realization that the pace of growth was outsized due to one-off factors (such as the swing in inventories) should not substantially alter the timing of rate hikes, which we continue to expect will begin in Q1-11. Finally, it is worth noting that the originally reported 3.5% Q/Q ann. gain in Q3 was eventually revised down to 2.2% Q/Q ann., and while we don't expect Q4 to be revised substantially lower, it is not inconceivable.

*Ian Pollick  
Economics Strategist  
TD Securities*



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